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Why the Poorest Countries are Failing and What Can be Done About it

by Paul Collier

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A large group of smallish countries totalling about a billion people have sheered off from the rest of mankind. As the world becomes more socially integrated this giant pool of poverty will be both unacceptable and explosive. It is the world's biggest economic problem and we need to do something about it. To know what to do we need to start with a diagnosis. While the common fate of the bottom billion has been stagnation and poverty there has been no single cause. In my recently published book *The Bottom Billion* I propose four distinct traps that between them account for the problem, each requiring a distinct remedy. I also argue that globalization, though it has been benign for the majority of the developing world, is not working for the bottom billion and is not likely to do so. On the contrary, it is liable to make them increasingly marginalized.

So what are the key policy issues? One is that Africa has failed to develop jobs in export manufactures, the strategy that has been transforming Asia. Bangladesh has generated nearly three million jobs by exporting garments. If Kenya could do the same, it would be transformed. But Asia's success has made it harder for Africa to get started. It will help by granting Africa better access to developed country markets. At present most of the G8 countries impose tariffs on imports of garments from Africa. There is one exception: the US. The US allows Kenya to export shirts duty-free into its market. Europe does not. Even the few African countries that are allowed duty-free access into Europe get blocked by absurd technical requirements: Lesotho sells thousands of shirts to America, but they do not satisfy the regulations of the European Union. As a result, over the last five years Africa's garments exports to Europe have declined while increasing sevenfold to the US. The G8 could easily adopt a common set of rules for these African exports that would generate jobs across the region. I proposed this to the G8, but they spent their time posturing over aid commitments.

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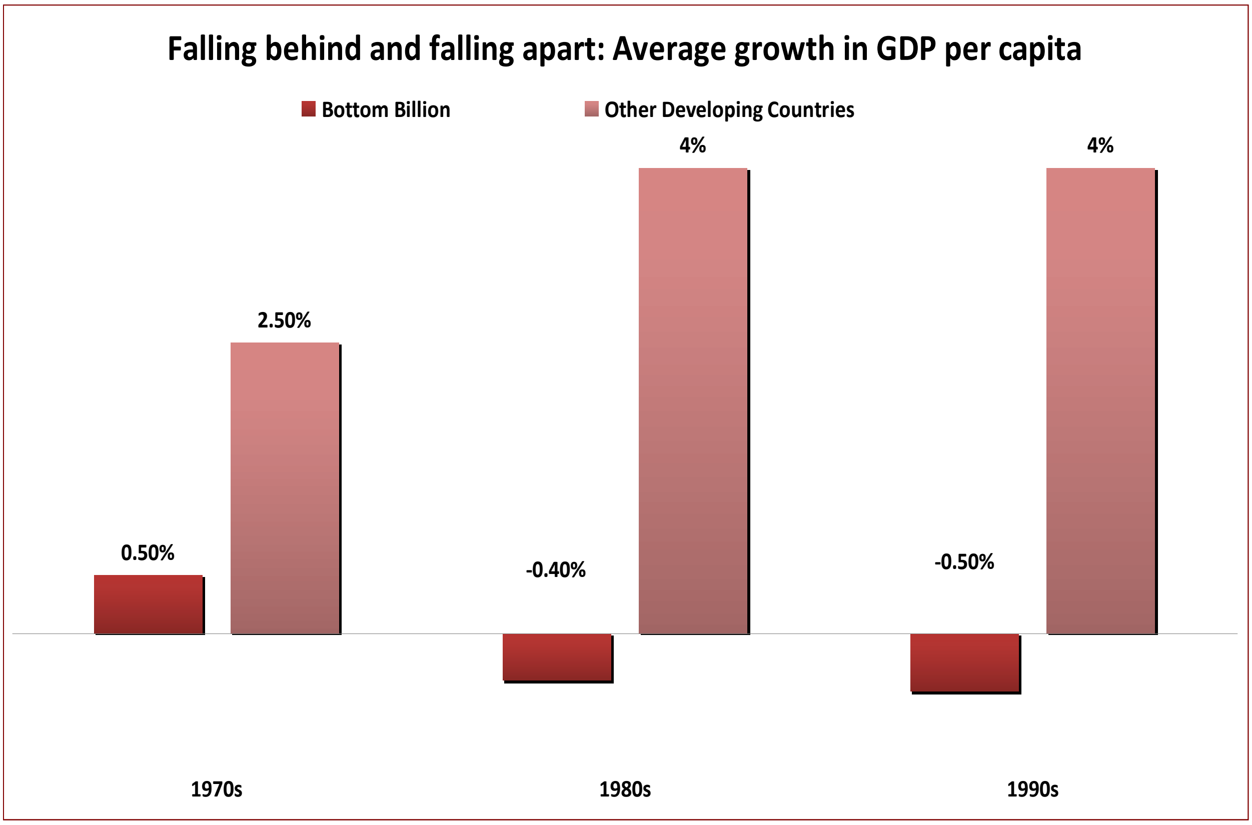
A second policy issue is that many of the countries of the bottom billion are now in the throes of revenue booms from oil and other minerals that dwarf any conceivable aid flows. The last time this happened was thirty years ago and it proved a disaster. The money corrupted the local politics so badly that not only was it wasted, it impoverished, sometimes even leading to civil war. Can the governments of developed countries do anything to reduce the risks of repetition? Well, where do corrupt politicians put



Source: *The Bottom Billion*. pp. 8-9.

'The experience of the societies in the bottom billion was thus one of massive and accelerating divergence' (p. 10)

their money? They certainly do not leave it in their own banks, it comes to banks in developed countries. And what do developed country banks do? Basically, they keep quiet about it. Is this a necessary consequence of banking secrecy laws? No it is not. If the money is suspected of having terrorist associations then, very sensibly, we now require the banks to blow the whistle on it. But if its stolen from the ordinary citizens of the bottom billion, well that is just too bad. It cost the reforming government of Nigeria huge legal fees to track down some of the previous president's millions in a Swiss bank, and even when they won their court battle the Swiss Minister of Justice blocked sending the money back.

A third policy issue is security. Quite possibly the most effective 'aid' Britain has ever provided was the troops that have secured peace in Sierra Leone. Britain currently guarantees the peace there through an 'over-the-horizon' commitment: if there is trouble, British troops will fly in. It has not been necessary: the commitment alone is sufficient. Civil wars have been devastating to Africa: the one in Sierra Leone delivered the coup de grace to an economy that had already been wrecked by revenues from diamonds. Across the region there are now several post-conflict situations that need this sort of commitment. To date, nearly half of all post-conflict countries revert to war within a decade: we should surely be able to make a difference here. Unfortunately, along came the war in Iraq and closed down serious discussion of Africa's security needs. The western powers are afraid that sending troops abroad will be unpopular, and the governments of the bottom billion fear that western involvement would license pre-emptive invasions.

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Trade in shirts, the governance of resource bonanzas, and security commitments are a more sophisticated agenda than simply doubling aid. However, I should stress that I do not see them as alternatives to aid but as complements. Think how the US responded to the need to rebuild Europe after 1945. It recognized that the problem was serious and addressed it through the full range of possible policies. Yes, there was a big aid programme, Marshall Aid. But this was complemented by a complete reversal of US trade policy, from protectionism to integration, through the founding of the GATT. It was also complemented by a reversal of US security strategy: from isolationism to mutual guarantees enshrined in NATO and over one hundred thousand troops in Europe for four decades. Finally, there was a dilution of the principle of absolute national sovereignty, with the creation of new structures for mutual support of good governance, enshrined in the founding of the OECD and the EEC. That is what happened when the US became serious. The challenge posed by the divergence of the bottom billion is evidently more difficult than that of rebuilding Europe. It will take that same full panoply of policies, although obviously the content of each policy will be different.

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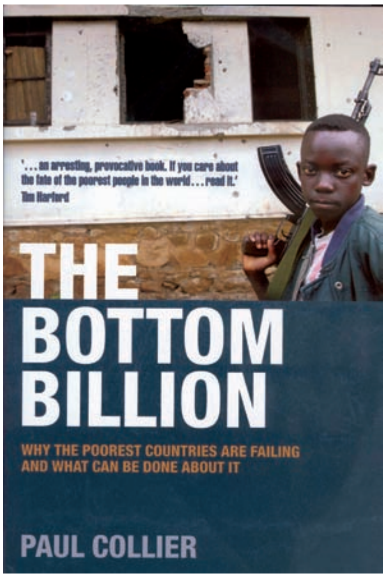
So, the message is to narrow our focus and broaden our instruments. Narrow our focus to the divergence of the countries now at the bottom of the world economy: a one-billion person problem. Our efforts will be spread too thin if we continue to fuss about the entire five billion people in developing countries. Broaden our instruments beyond the exclusive reliance upon aid, to recognize that other policies are likely to matter more. Our aid agencies need to be rethought as genuinely development agencies.



'The Bottom Billion is a serious book but an easy read. I tried to make it an easy read because I realized that the policies of the G8 governments towards development were increasingly being set by politicians trying to please their own voters. Inadvertently, the same process that has succeeded in getting development onto the political agenda, which has been the lobbying of rock stars and NGOs, risked trivializing its policy content. It is time for academics to set aside our tendency to write only for each other, and to reach out to our fellow citizens, communicating our expertise.

While the style is light, the content is entirely about economic research, essentially pulling together my recent research with a number of colleagues. This pulling together is also increasingly rare in academic behaviour. Our work is now overwhelmingly presented in article-sized nuggets with few serious outlets for more sustained analysis.' – Paul Collier

Paul Collier delivering the keynote address at the WIDER Conference on Fragile States – Fragile Groups on 15 June 2007 in Helsinki.

He is the co-author of the following recent WIDER research papers on fragility and development:
RP2007/16 Lisa Chauvet, Paul Collier, and Anke Hoeffler: Paradise Lost: The Costs of State Failure in the Pacific;
RP2007/30 Lisa Chauvet, Paul Collier, and Anke Hoeffler: The Cost of Failing States and the Limits to Sovereignty.

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The Bottom Billion: why the poorest countries are failing and what can be done about it, is published by Oxford University Press.

Applying Behavioural Economics to Development Policy

by C. Leigh Anderson and Kostas Stamoulis

Behavioural economics combines the insights of psychology and economics to better understand and predict decision making by considering how, for example, emotions and attitudes (psychological tendencies) influence how preferences translate into choices.

Applying behavioural economics to development policy is a particularly relevant, but neglected, field of inquiry given that in developing countries the poorly educated, the spatially isolated and those in highly risky environments, may be disproportionately represented in the group for whom standard models do not regularly apply—and further, that behaviours may more acutely affect policy outcomes because there are fewer formal institutions, such as credit and insurance markets, to temper their effects.

Despite the growing literature on development policy we are still unable to fully understand how the poor make decisions, especially under uncertainty and over time. It is not clear why, for example, individuals do not regularly adopt subsidized technologies such as ventilated cooking stoves to reduce health risks. They avail themselves less than predicted in health programmes, participate less than expected in market opportunities, under or over insure themselves, and make short-run decisions that are inconsistent with their long-run welfare. The rise and fall of different paradigms of poor household behaviour can partly be attributed to this limited understanding. We believe that some more helpful answers may lie within behavioural economics, that these insights are particularly important for poor and rural populations, and that they can improve the future design, implementation and subsequent effectiveness of development policies and programmes.

Though there are many examples that challenge standard economic models we consider three that we find particularly salient for development: decision making under uncertainty, intertemporal choices, and social preferences.

Decision-making Under Uncertainty

Poor individuals live in risky environments, with fewer mechanisms for smoothing the variability that underlies the uncertainty. How they deal with uncertainty depends on three aspects: the qualitative dimensions of risk, decision rules with known and unknown probabilities, and the framing of choices as gains and losses (reference dependence). We will briefly discuss each.

Individual and social tolerance of a risk depends upon its quantitative and qualitative characteristics, including magnitude, certainty, voluntariness, dread, proximity and distribution of impacts. Individuals systematically overestimate the size of risks that are small, novel, unfamiliar, involuntary and uncertain, and underestimate the size of risks that are more certain, larger, familiar or somewhat voluntary. For instance in Chiapas, Mexico, farmers were willing to pay for local and improved variety seeds that decreased the frequency and magnitude of maize crop loss. Farmers stated a higher willingness to pay to reduce catastrophic loss from drought, and chronic loss from pests, than for exactly the same loss reduction from wind lodging. Our results suggest that the technology with which a crop loss is reduced may be less important in adoption than perceptions of control and dread over the environmental risk causing the loss.

Traditional models assume that individuals make fully reasoned and consistent choices. Yet regular observation and repeated experiments suggest that individuals often employ 'fast and frugal' heuristics; rules that allow them to make decisions either in the absence of full information or when they are unable or unwilling to incorporate all the information that is available in the relevant timeframe.

These rules may lead to errors in probability judgments. Common heuristics are availability, anchoring, and affect, whereby people estimate frequency by the ease of recalling vivid or recent events, by using arbitrary amounts as bases, or by their preference for an outcome. These heuristics can affect evaluations of expected costs and benefits in resource allocation decisions.

Reference dependence has been regularly confirmed in a variety of experiments. Alternatively attributed to an endowment effect, loss aversion, or a status quo bias, the result is that preferences vary according to the direction of change. In general, individuals are more sensitive to losses than equivalent sized gains—with losses often being weighed more than twice as heavily as gains. Previous questions around insurance behaviour are now attributed to consumers overweighting small probabilities. For developing countries, a recent overview of crop insurance studies concludes that the costliness of informal household risk management strategies imply a positive demand for a fair value insurance contract. Yet crop insurance has been a 'near-universal' failure on a financial basis. Common explanations include the covariant risks in agriculture, moral hazard and adverse selection, and insecure property rights. But behavioural evidence also implicates discrepancies between perceived and measured risk. For example, contrary to popular insurance for earthquakes—a vivid and dreaded, but low likelihood event —the higher likelihood, but more familiar crop loss evokes enough risk seeking behaviour to render insurance programs unsustainable.

Intertemporal Choice

Contrary to standard discounted utility models that assume constant discount rates evidence suggests that short-run discount rates, experienced at the moment, are higher than the long-run discount rates we project forward. Hence people with time varying discount rates, if they lack perfect self-control, may pursue short-run actions that they had previously calculated were not in their best long-run interest—they may consume their savings, fail to stick to a debt repayment schedule, skip school or job training opportunities, exploit natural resources unsustainably, or choose occupations that require little human capital investment.

Standard economic theory posits that individuals can only be made better off with access to credit, since they can always choose not to avail themselves of it. But even with good intent, the optimal payback plan of individuals can change over time, creating repayment difficulties. Naïve consumers, so called because they are unaware of their self-control problems, repeat regrettable behaviours. Sophisticates, on the other hand, can anticipate their inconsistency and seek ways to decrease liquidity and help bind their future behaviour. Evidence from Africa and Asia indicates that relatively simple institutional mechanisms can help align short run choices with long-term preferences, such as lock boxes, money guards, deposit collectors, limited withdrawal savings accounts, and rotating savings and credit associations.

Social Preferences

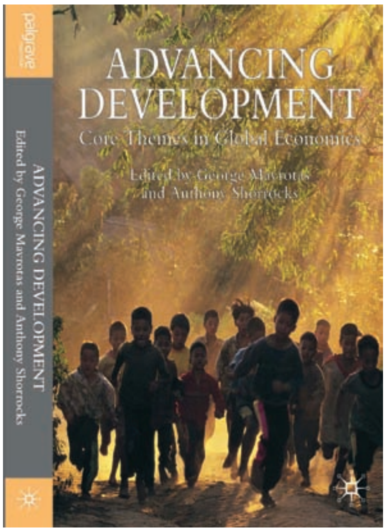
Social preferences influence market and exchange behaviour. Repeated experiments suggest that individuals are willing to suffer monetary losses to punish opponents for outcomes or intentions perceived as unfair. Other results suggest that consumers perceive price increases arising from seller cost increases as fair, but not price increases in response to demand fluctuations—and oddly enough, without any information about the base profit levels of the seller.

Providing for public goods also counters traditional wisdom. For example, studies suggest that people are more likely to contribute to public goods when they believe others are also doing this, even though from an efficiency perspective the marginal social benefits are highest when no one else is contributing.

Conclusion

Though behavioural economics has been slow to penetrate development policy, interest is growing at organizations such as the International Fund for Agricultural Development and the FAO

The challenging questions for future research, we believe, are around measurement and scale. To be useful, easily measurable correlates of unobservable attitudes need to be found, and the specificity of reference levels and context must be scaled up. And just as institutional perspectives have become part of the mainstream we will eventually overcome our own 'status quo' bias about incorporating more psychological realism into our models.



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See the chapter 'Applying Behavioural Economics to International Development Policy' by C.L. Anderson and K. Stamoulis, in *Advancing Development: Core Themes in Global Economics*, edited by George Mavrotas and Anthony Shorrocks, published by Palgrave Macmillan (paperback) 9780230019041.

Globalization, Growth, and Poverty in Africa

by Machiko Nissanke and Erik Thorbecke

African countries have benefited relatively less from the positive effects of globalization than other parts of the world in terms of economic growth and development. Following largely an inward-oriented development strategy in the early decades of the post-independence period, the majority of African countries failed to take advantage of the opportunities provided by the dynamic growth impetus associated with globalization in the 1970s and 1980s. Instead of becoming more integrated into the world economy, they were largely marginalized and experienced slow growth and stagnation.

As a result the incidence and depth of poverty has risen in the region. The number of poor, measured in income poverty based on the US$1 a day international poverty line, increased in Africa, almost doubling from 164 million in 1981 to 313 million in 2001. In terms of the headcount ratio, the poverty incidence in Africa is 46 per cent in 2001—the highest in the world. Poverty in Africa is both most prevalent and severe in rural areas. Poverty measured in terms of non-income indicators such as health and education has not improved much either over the past 15-20 years in the region. The overall picture gives little cause for optimism that Africa will soon reap the benefits of the process of globalization, unless it scales up efforts in a number of fronts including adopting a more pro-poor pattern of growth and increasing the provision of public services in the social sector. Further, the degree of income inequality in Africa has increased sharply in the last two decades. Today, many countries in Africa suffer from a relatively high intra-country inequality which is among the highest in the world.

With growing recognition of the need to grow faster, most African countries have increasingly searched for ways to accelerate their participation in the global economy over the past two decades. Indeed, most economies in Africa significantly liberalized their trade and investment policy regimes as part of Structural Adjustment Programs since the mid 1980s.

However, in spite of this Africa's share of total world trade has fallen between 1980 and 2002: Africa's share of world exports falling from about 6 per cent to 1.5 per cent, and imports from 5 per cent to 1.5 per cent. Many countries in Africa have also intensified their efforts to attract foreign direct investment with various fiscal and other incentive measures. Yet, foreign direct investment (FDI) flows to the region so far have been largely limited to extraction of oil and other natural resources. Africa attracted only around 6 per cent of total net FDI inflows to developing countries in 2000-4.

The recent upturn in economic growth recorded in many natural resource-rich economies in Africa is closely associated with the price hike of oil and mineral commodities in the world markets. The sustainability of growth rates of 6-7 per cent recently observed in these economies will be dependent on the degree to which commodity booms are used purposely for diversification and transformation of economic and trade structures.

Indeed, today, several decades after gaining political independence, the high primary commodity-dependence remains one of most conspicuous characteristics of the trade pattern of countries in Africa with the rest of the world. The failure of these economies to diversify and undergo structural transformation, and hence, to benefit from the technology-driven, highly dynamic aspects of on-going globalization has entailed a high cost to the region not only in terms of low economic growth but also in persistent poverty. In particular, the past neglect—if not overt exploitation—of agriculture in many African countries short-circuited the development process as agriculture is the only potential engine of growth at an early development stage.

There is no doubt that sustained poverty reduction requires economic growth. However, the pattern of growth does significantly affect the rate of poverty reduction. In this context, it can be argued that Africa's growth has been distinctly against the poor not only in terms of its ability to deliver the required growth rate to ensure that the poor could benefit from economic growth, but also in terms of its structure. Economic growth in Africa, where it has occurred, has not been translated into significant poverty reduction. Critically, the nature and pattern of integration into the global economy in Africa as well as domestic conditions has not been conducive to generating virtuous cycles of globalization-induced growth as generally observed in Asia. Africa has paid a high price for its neglect of agriculture which continues to be the Achilles' heel hindering the take-off into sustained growth in many of the poorest and least developed countries.

In most of East Asia, the structural transformation of their economies has been considerably facilitated by the integration/globalization process (see Nissanke and Thorbecke 2008). The growth—accompanied by a substantial reduction of abject poverty—in East Asia can be explained in terms of the region-wide comparative advantage recycling in production and export of labour-intensive goods. The process involves a strong demand for unskilled and semi-skilled labour, driven by exporting labour intensive goods and pro-trade FDI through effective technology, knowledge and skill transfer. Most of the East and South-East Asian economies have successfully gone through the structural transformation of their production and trade structures with continuous upgrading of their human skill endowments and technology/ knowledge base. By relying on their dynamically evolving comparative advantages these countries were able to maximize the benefits from dynamic externalities. Specialization in sectors with large spillovers and dynamic externalities is more apt to engender a pattern of equalizing growth.

Moreover, in most of East Asia, the pro-poor pattern of public expenditure in favour of the rural poor and the agricultural sector during early stages of development produced and sustained the 'shared' growth process. There were concerted efforts on the part of governments to facilitate building primary assets of the poor through such measures as an equitable distribution of land (through appropriate land reforms); extensive public provision of free and universal primary education; promotion of small-scale enterprises and development of rural infrastructure – roads, irrigation, schools, agricultural support outposts, health stations, and irrigation systems.

In contrast, the high susceptibility and vulnerability to exogenous shocks through its fragile trade linkage may have left Africa behind and suffering from vicious cycles of globalization-induced decline. Many parts of Africa remain isolated from global markets and the global community as the region's access to information and technology is limited. There is some evidence to suggest that in Africa 'globalization may be associated with increasing inequality and (hence) with an increase in poverty' (see Round 2007).

In short, while globalization has made some contribution to economic growth in Africa, it has not yet facilitated the process of structural transformation required for countries in Africa to reach the take-off stage and accelerate economic development and poverty reduction. Instead, globalization has tended to increase intra-country inequality and has done very little to reduce poverty. Naturally, the impact of globalization on poverty is extremely context-specific. In general, however, the limited scope of globalization in Africa appears to be the result of a combination of poor initial conditions, such as fundamental disadvantages of location (disease-prone tropical countries with a harsh environment); inadequate political institutions; extremely under-developed physical infrastructure, and a related high risk investment climate. Progress on all these fronts will be necessary if Africa is to enjoy the potential benefits of globalization.

Readings

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Stranger than Fiction? Institutions and Economic Development

by Ha-Joon Chang

Mainstream economists used to treat institutions as mere 'details' that gets in the way of good economics. Then from the mid-1990s, everyone, including the IMF and the World Bank, suddenly started to emphasize the role of institutions in economic development. There are a few reasons behind this rather dramatic change. First, the institution-free technocratic reform programmes of the 1980s have almost universally failed. Second, a number of devastating large-scale financial crises in developing countries around the turn of the century have prompted debates on the need for reforming financial and other institutions in order to prevent and deal with such crises. Third, there have been increasing attempts by the developed countries to introduce 'global-standard' institutions to developing countries. Fourth, there have been some important theoretical developments in institutional economics—both orthodox and heterodox.

Stranger than Fiction?

Despite the heightened interests in institutions, there are still some important gaps in our understanding. First of all, we still do not know what institutions in exactly which forms are useful for economic development in which contexts. For example, everyone may agree that a 'good' property rights system is essential for economic development, but there is no agreement on what a 'good' property rights system is. Second, even when we can identify a particular institution as beneficial in a given context, we often do not know how we can build such institution.

A recent WIDER volume[1] argues that, in order to fill these intellectual gaps, we first need to develop new discourses on what may be called the 'technology of institution building'. For example, it is not enough to say that developing countries need better fiscal institutions. We need to be able to tell them how to build such institutions. Second, we need more case studies of institution building—historical and more recent. Real life experiences of institution building are often 'stranger than fiction'—that is, they are often more imaginative than what theoreticians have suggested on the basis of broad generalization and abstract reasoning.

Against 'Institutional Mono-tasking'

Institutions can, and do, serve multiple functions. Unfortunately, in the mainstream discourse, there has been a tendency to assign a single function to each institutional form, described as 'institutional mono-tasking'.

The failure to understand the functional multiplicity of institutions means a failure to fully exploit the potential of an institution. For example there are many developmental functions of a central bank that are neglected because of the currently dominant view that the sole function of the central bank is to guarantee price stability.

Institutional mono-tasking also makes it easier for particular interest groups to hijack certain institutions and make them work mainly to their advantages. Shareholder-oriented institutions of corporate governance have often allowed shareholders to assert their interests over those of other stakeholders in the firm and of the broader society.

Politics of Institutional Change

Institution building cannot simply be a technocratic exercise. All institutions, including the market (which is often assumed by mainstream economists not to be an institution) are defined in relation to the structure of the rights and obligations of the relevant actors. As the definition of those rights and obligations is ultimately a political act, no institution, including the market, can be seen as being free from politics.

The politics involved in institution-building process can often be very unpleasant. The efficient tax institutions of early modern Britain fuelled its imperialist expansion and repression of lower classes at home in the name of protecting private property. At one level, this 'dark' origin of certain institutions limits their applicability. For example, few would recommend that developing countries create institutions that repress the poor to emulate the British economic success in the eighteenth century. However, institutions can be used for purposes that were not originally intended, and therefore the 'darkness' of their origins need not keep us from using them for better purposes.

Structure vs. Human Agency

In the mainstream theory of institutional change, there is no real human agency, because what a rational actor will choose is already structurally determined. However, case studies show that history has developed the way it has because someone somewhere made choices that were not obvious according to the structural parameters.

If human actors are not automata responding to structurally-determined incentives, their ideas matter a great deal. Sometimes ideas can be used as tools by human agents in their attempt to change institutions in the way that they prefer. The American professional managerial class has been able to use the shareholder-value ideology, which identifies it as main targets of restraint, in a way that allowed it to build institutions that enrich itself (e.g. stock options). However, ideas are not merely tools that human actors cynically manipulate in order to make the institutional changes that they prefer. Institutions affect the ideas that human actors hold, and therefore they shape the human actors.

Unintended Consequences and Intended Perversions

Emphasizing human agency does not imply that those who plan and implement institutional changes are in full control of the situation. There are unintended consequences of institutional change—positive or negative.

However, the failures of certain institutions to serve their original functions may not always be unintended. Some actors may deliberately choose to use them for purposes other than the original ones. Patents for instance may be turned into vehicles of rent-seeking (as in the case of Britain at the time of Adam Smith) or even an obstacle to innovation (as in the recent extension of patents to the genetic level).

Such institutional perversion need not be a negative thing. It has been shown that despite its apartheid origins, the rather effective institutions of taxation in South Africa are slowly beginning to be used for redistributive purposes.

The Technology of Institution Building

Although there is a diversity of institutions across time and place it should not be taken to imply that there are no common principles in the technology of institution building that can be applied across countries.

Institutional reform may be more effectively initiated by introducing desired economic activities than by introducing the desired institutions, as the current orthodoxy goes. In other words policy-makers should target the kind of activities that would bring the right kinds of institutions, not the other way around.

Moreover, even when we agree that some institution is likely to be good, there is always a danger of 'institutional overdose'. For example, even if some protection of private property is absolutely necessary, it is wrong to infer from that the stronger the protection is the better it is, as the conventional wisdom goes.

Concluding Remarks

The recent WIDER volume shows that there is no universal formula for institutional change that will promote economic development. Functional multiplicity, the importance of informal institutions, unintended consequences, and intended perversion of institutions all imply that importation of best practice formal institutions does not guarantee any particular positive outcome, even assuming that the imported institution can actually take root in the importing country. The fact that there is no set formula, however, should not make us think that there is nothing we can do to improve the quality of institutions in developing countries.

First of all, being late-comers, developing countries have the benefit of being able to imitate institutions that exist in the more developed countries–of course, with due local adaptations–and thus cut down the costs associated with developing new institutions *de novo*. Second, historical experiences show that countries do not have to start with high-quality institutions. It is perfectly possible to improve the quality of institutions while the country is developing its economies, with economic development and institutional development feeding into each other.

There is no universal formula for institutional development. However, even in this inherently complex area, it is possible to extract some general principles and enrich our empirical knowledge, especially if we are willing to go beyond the rather narrow theoretical and empirical confines of today's orthodox discourse on institutions.

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[1] Institutional Change and Economic Development
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A Fiscal State with its Royal Navy: Institutions and the Industrial Revolution

by Patrick Karl O'Brien

'Good' institutions have become a core ingredient of most modern day explanations of economic growth and development. The recently published WIDER book on *Institutional Change and Economic Development* (see the previous *Angle* article by Ha-Joon Chang) emphasizes that what is appropriate as an institutional framework for development in one context, might not be appropriate in another. This implies that there might be important historical specificity in the relationship between institutions and development. In this article I illustrate this link between institutions, history and development, by describing the institutional context which led during the eighteenth century to the First Industrial Revolution, arguably one of the most significant events in the economic history of the modern world. Why, and how, did the Industrial Revolution happen to take place in the United Kingdom (UK) when it did?

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The Battle of Trafalgar 1805 as seen from the mizen starboard shrouds of HMS Victory

In this article I argue that to some significant degree an Industrial Revolution emerged in the UK as the outcome of aggressive and successful mercantilism. In the beginning was a fiscal state with its Royal Navy.

The Formation of a Fiscal State

Not long after the First Hundred Years War (1337-1453) when England's feudal armies had ignominiously retreated from centuries of dynastic and imperialistic warfare on the mainland, the island's kings, aristocrats and merchants began to conceive of naval power as the first line of defence against external threats to the security of their realm and as the force required to back conquest and commerce with continents other than mainland Europe. For several reasons that conception took nearly two centuries (1453-1649) to mature, one of the most important being that the aristocracies and the propertied elites assembled in the Houses of Lords and Commons successfully resisted all attempts by the Crown to deepen and widen its fiscal base in order to fund the resources required to establish armies and navies of sufficient scale, scope and technological capability to defend the realm, maintain internal order and protect private investment in commerce and colonization overseas.

Eventually nearly two centuries of fiscal stasis, economically malign, disputes over religion and persistent acrimony over the crown's rights to taxation, culminated in an 'interregnum' of highly destructive civil war, republican rule, and the restoration of monarchy and aristocracy. As well as truly massive destruction of life and capital, this famous interregnum witnessed: the most serious threats to hierarchy and property rights in English history; the appreciation by wealthy elites of the advantages attending the establishment of a standing fleet of warships under control of the Crown as well as the externalities generated by a Royal Navy for the maintenance of that other and equally significant public good—internal order.

Following on from a series of republican and royalist experiments with the political principles, methods of assessment and collection of taxes, a 'reconstructed' fiscal base came into place under the restored Stuart monarchy. Constitutionally that base rested, first and foremost, upon the reaffirmation by the Crown of the long-established tradition (challenged under provocation by Charles I) that English monarchs could not levy taxes without formal consent from Parliament. Thereafter, Parliament never presumed to control royal expenditures and hardly ever withheld consent for supply; particularly in wartime.

The Royal Navy

> *It is upon the Navy under the Providence of God that the safety honour and welfare of this realm do chiefly attend*
>
> *Preamble to articles for the First Anglo-Dutch War, 1652-54*

The maritime strategy pursued for the defence of Britain was taken forward during the Commonwealth to mature into a well-funded and binding commitment by the state to a standing navy of the size and technical capability required to preclude invasions of the Isles from offshore. That commitment which continued to our own era of airpower made sense to an isolated Republic threatened with Royalist inspired privateering on its trade, with invasions supported by outraged kings from the mainland, but in possession of funds (realized from the sale of the expropriated wealth of the monarch and his treasonable supporters) to invest heavily in the construction of warships.

Persistently high levels of public expenditure on the Royal Navy probably exceeded allocations for gross domestic capital formation between 1760 and 1810 and in times of war amounted to around half of the value of Britain's exports, plus re-exports. This commitment provided the kingdom with Europe's (the world's) largest fleet of battleships, cruisers and frigates, manned by a largely coerced workforce of able seamen, managed by well motivated officers.

The relatively low costs, and in outcome, highly successful and economically significant offshore strategy for defence allowed the British state to spend more upon armed forces and to allocate greater proportions of its already elastic fiscal and financial resources not only to complementary mercantilist and imperial missions pursued at sea, but to sustain surprisingly high levels of military expenditure. Throughout the period 1688-1815, the military share of expenditures on armed forces by the European state most committed to naval defence and aggression amounted to a modal 60 per cent.

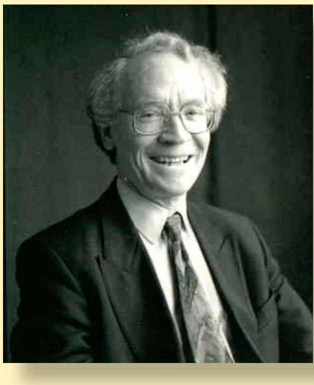
Prospects for trade across a 'less than united' Kingdom came, from time to time, under serious threat from within the potentially seditious provinces of Scotland and Ireland; particularly the latter where a colonized Catholic population resented 'English' property rights and the metropole's discriminatory regulation of local commerce and industry. With external security taken as given, stability, good order, respect for an established inegalitarian system of property rights and the maintenance of hierarchy over their potentially unruly employees became a key political-*cum*-economic interest for landowners, merchants, farmers, industrialists and other businessmen of Hanoverian Britain.

On the whole, their 'monarchical and aristocratic' state met concerns for the protection of property, for the maintenance of authority over workforces and when necessary redefined their legal rights by promulgating statutes for the realm which superseded custom and common laws that could be interpreted as providing protection for the welfare of the majority of the nation's workforce without assets, status and power.

Conclusions: The Security, Stability, and Growth of the Realm

Somehow through eleven wars the Royal Navy retained command of the Channel and the North Sea. Throughout the period which witnessed Britain's combined geopolitical and economic rise, the Navy's guard over Western and Eastern approaches to the Isles, blockades of enemy naval bases, the interdiction of their supplies of strategic raw materials and weapons and occasional pre-emptive strikes effectively prevented a rival fleet from clearing a viable sea route for the landing of armies on the kingdom's shores.

In wartime the proportions of the British workforce (particularly skilled artisans) drafted into the army (the country's secondary line of defence) remained low. Troops (and embodied militias) required for defence and service overseas could, moreover, be recruited overwhelmingly from among the unskilled potentially unemployed fringes (often Celtic and Colonial) of an expanding imperial workforce or, when necessary, hired as mercenary soldiers from labour abundant societies on the mainland. Furthermore, and while the Navy operated as the realm's main relatively cheap but highly effective first line of defence, the state funded and maintained a royal army which (together with local militias) remained on call and active for the preservation of the internal order necessary for investment and economic growth.

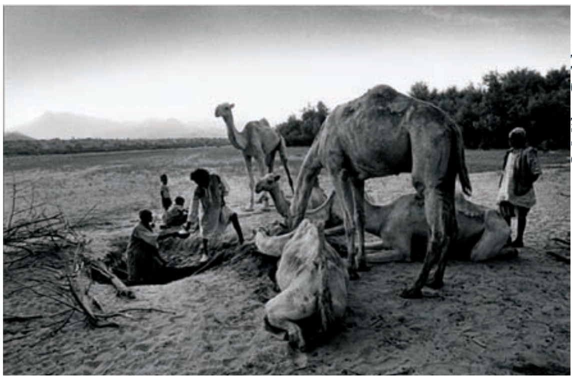


Patrick Karl O'Brien, former Director of the Institute of Historical Research at the University of London and past president of the British Economic History Society, is now a Centennial Professor of Economic History at the London School of Economics where he acts as Convenor of the Global Economic History Network (GEHN).

This article is based on WIDER Research Paper (2006/75) 'The Formation of a Mercanilist State and the Economic Growth of the United Kingdom 1453-1815' that was prepared within the WIDER project on 'Institutions for Economic Development: Theory, History, and Contemporary Experiences', directed by Ha-Joon Chang.

WIDER Conference

Fragile States – Fragile Groups: Tackling Economic and Social Vulnerability



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WIDER Conference

Southern Engines of Global Growth: China, India, Brazil, and South Africa

© Lehtikuva / Reuters / Stringer (China)

WIDER hosted two major international conferences during 2007 in Helsinki, on themes that reflect the increasing diversity in development performance across the world. The first conference, on 'Fragile States – Fragile Groups' was held on 15-16 June 2007. Many of the world's poorest and most vulnerable countries are classified as fragile states, and a disconcerting number are described as failed states. At this conference, attended by over 100 participants from universities, research institutes and official donor organizations, the various dimensions affecting the development of the more than 350 million people living in extreme poverty in these countries was scrutinized.

Papers presented dealt with the concept and measurement of state fragility and household vulnerability, the impact of conflict on household vulnerability, financial and trade shocks, aid and mechanisms to improve aid effectiveness, food insecurity, environmental shocks, the role of women, the impact of HIV/AIDS, the potential of microfinance, the causes and consequences of migration, and with strategies for dealing with state fragility and household vulnerability. In his opening address, Dr Rob Vos, Director of Development Policy Analysis at UN-DESA emphasized the need for expanding the economic security of the poorest of the poor. The keynote speeches were by Paul Collier on 'Elections and Reforms in Failing States' and Patrick Guillaumont on the 'Design of an Economic Vulnerability Index and its use for International Development Policy'.

Special parallel sessions were organized in collaboration with the United Nations Department for Economic and Social and Affairs (UN-DESA) on economic security, and with the United Nations University Institute for Environment and Human Security (UNU-EHS) on environment shocks and global insecurity. The Household in Conflict Network (HiCN) organized a parallel session on conflict and instability and its effects on poor households. The conference concluded with a roundtable discussion on how to improve the economic security of fragile states and fragile groups.

WIDER's second major development conference of 2007, on the theme of the 'Southern Engines of Global Growth', took place in Helsinki on 7-8 September 2007. The conference reflects the fact that China, India, Brazil and South Africa (CIBS) have an important impact on the global economy through growth and trade effects, and their roles in financial markets. Meanwhile, by forging political alliances among themselves and with others, they are increasingly active and vocal on the world stage. As argued and discussed during this two-day conference, the 'rise of CIBS' is expected to have profound implications for international governance.

A total of 173 delegates from 31 different countries participated in the conference, which was opened by the Governor of the Bank of Finland, Erkki Liikanen. The main themes addressed at the conference included growth, trade, international finance, global governance, and geopolitics, and comparative studies. The keynote addresses were given by Eliana Cardoso 'Some Comparisons with China and India on Trade Exchange Rates, and Tax Reform', and Deepak Nayyar 'China, India, Brazil and South Africa in the World Economy: Engines of Global Growth', and special parallel sessions were organized in collaboration with the Bank of Finland and the South Centre.

For more information

www.wider.unu.edu

WIDER Special Events and Book Launch

Alexander Zachn

The speakers of the first plenary session of the WIDER Conference on **Fragile States – Fragile Groups: Tackling Economic and Social Vulnerability,** organized in Helsinki on 15-16 June 2007. From left: Paul Collier, Rob Vos, and Patrick Guillaumont.

The speakers of the concluding plenary session were Beatriz Armendariz, Paul Mosley, David Hulme, Nazrul Islam, and Rob Vos.

The keynote speakers of the first plenary session of the **WIDER Conference Southern Engines of Global Growth: China, India, Brazil, and South Africa** organized in Helsinki on 7-8 September 2007. From left Eliana Cardoso and Deepak Nayyar who discussed the major topics of the conference: growth, trade, fiscal policy, capital flows and global governance.

The governor of the Bank of Finland Mr Erkki Liikanen delivered the opening presentation.

Alexander Zachn

Ida Folkesson

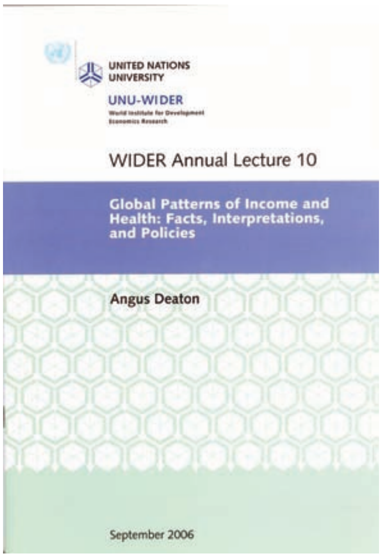
Launch of the WIDER study on **Measuring Human Well-being: Key Findings and Policy Lessons** presented by Mark McGillivray (second from left) and Farhad Noorbakhsh (on right), with James Foster, discussant (second from right). Jean-Marc Coicaud (on left) chaired the session, which took place at the UN headquarters in New York, 17 September 2007.

The event attracted considerable attention from UN, development and policy communities in New York.

WIDER Publications

2006 WIDER Annual Lecture

WIDER Annual Lecture 10
Global Patterns of Income and Health: Facts, Interpretations, and Policies
by Angus Deaton



It is now widely agreed that comparisons of living standards across countries, or across households within countries, should ideally go beyond measures of income or expenditure and encompass non-income dimensions of well-being, in particular health. Since income and health are positively correlated, adding the health dimension tends to exacerbate the inequality related to income differences alone.

Policy Briefs

Measuring Human Well-being: Key Findings and Policy Lessons
David Clark and Mark McGillivray
UNU-Policy Brief 3, 2007

An outcome of the WIDER research project Social Development Indicators that sought to provide insights into how human well-being might be better conceptualized and, in particular, measured, this Policy Brief outlines a contextual background to the project. The study introduces some key concepts and measures used in assessing achieved well-being, especially at the national level, and some of the best known and most widely used well-being measures are highlighted. The Policy Brief goes on to provide an overview of the five edited volumes that emerged from the project, summarizing some of the main conclusions.

The Significance of Transport Costs in Africa
Wim Naudé and Marianne Matthee
UNU-Policy Brief 5, 2007

The success of Africa's exports, as well as its spatial development, depends on lowering transport costs. This Policy Brief addresses pertinent questions such as 'what are transport costs?', 'do transport costs matter for trade?', 'how important are transport costs in practice?', and 'why are Africa's transport costs so high?' A case study of the firm location decisions of exporters in South Africa illustrates the significance in particular of domestic transport costs for manufactured exports. The message that arises is that Africa's international transport costs are significantly higher than that of other regions, and its domestic transport costs could be just as significant. Moreover it is shown how domestic transport costs influence the location, the quantity, and the diversity of manufactured exports. Various policy options to reduce transport costs in Africa are discussed.

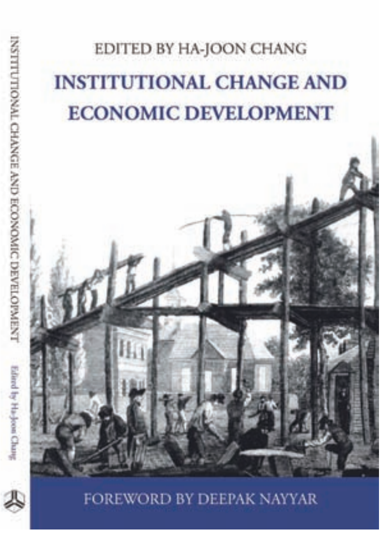
Stranger than Fiction? Understanding Institutionl Change and Economic Development
Ha-Joon Chang
UNU-Policy Brief 6, 2007

The volume Institutional Change and Economic Development fills some important gaps in our understanding of the relationship between institutional changes and economic development. It does so by developing new discourses on the 'technology of institution building' and by providing detailed case studies—historical and more recent—of institution building. It is argued that functional multiplicity, the importance of informal institutions, unintended consequences, and intended 'perversion' of institutions all imply that the orthodox recipe of importing 'best practice' formal institutions does not work. While denying the existence of universal formulas, the volume distils some general principles of institutions building from theoretical explorations and case studies.

Books

Institutional Change and Economic Development
Edited by Ha-Joon Chang
UNU Press (paperback)
9789280811438
—North America / Geneva edition
Anthem Press (paperback)
9781843312819
—UK / Europe / South Asian edition, October 2007

Recognizing the complexity of the issues involved, this book draws together contributions from scholars in economics, history, political science, sociology, public administration and business administration. These experts discuss not only theoretical issues but also a diverse range of

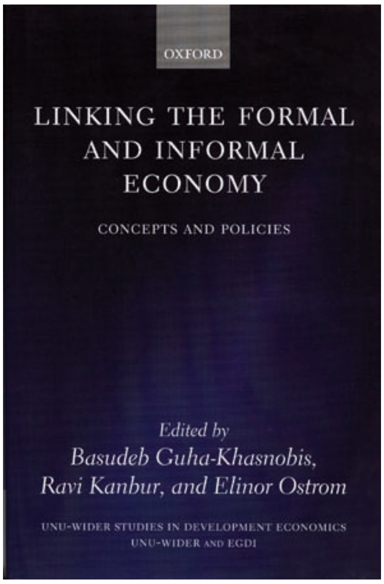


real-life institutions—political, bureaucratic, fiscal, financial, corporate, legal, social and industrial—in the context of dozens of countries across time and space—spanning from Britain, Switzerland, and the USA in the past to today's Botswana, Brazil, and China. The contributors show that there is no simple formula for institutional development. Instead, real-life experiences of institutional development have been achieved through a mixture of deliberate imitation of foreign institutions and local institutional innovations.

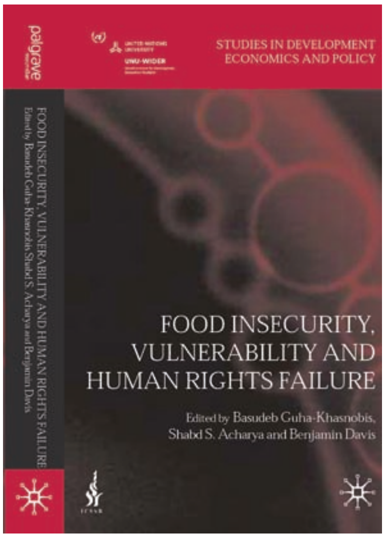
New in Paperback

Linking the Formal and Informal Economy: Concepts and Policies
Edited by Basudeb Guha-Khasnobis, Ravi Kanbur, and Elinor Ostrom
(paperback) 9780199237296
October 2007
UNU-WIDER Studies in Development Economics
Oxford University Press

Multidisciplinary in nature, with contributions from anthropologists, economists, sociologists, and political scientists. Contains new empirical research on the linking and interaction of formal and informal sectors in developing economies.



Food Insecurity, Vulnerability and Human Rights Failure
Edited by Basudeb Guha-Khasnobis, Shabd S. Acharya and Benjamin Davis
(hardback) 978023055376
October 2007
Studies in Development Economics and Policy
Palgrave Macmillan



Do we have a right to food? The significance of a human rights approach, and the way in which it translates to gender considerations, with links to the HIV/AIDS pandemic, agricultural productivity and the environment, adds a new dimension to the problem of world hunger. By exploring these approaches to hunger this volume is novel in its shift away from rather obvious research on macro food availability to more composite dimensions cutting across economics, sociology, law and politics. With regional experiences and country case studies this constitutes an invaluable collection for researchers and activists trying to make a difference.

Forthcoming Books

Food Security: Indicators, Measurement, and the Impact of Trade Openness
Edited by Basudeb Guha-Khasnobis, Shabd S. Acharya and Benjamin Davis
(hardback) 9780199236558
December 2007
UNU-WIDER Studies in Development Economics
Oxford University Press

Hunger is addressed from a variety of perspectives that are new and relatively under-researched. The emergence of the WTO and the freeing of agricultural trade, for example, have serious implications for hunger and food security in many countries. The book examines the issue across regions. It also presents several technical, regional, and country case studies that facilitate comparisons. It tackles food security at three distinct levels—national, household, and individual.

Understanding Inequality and Poverty in China
Edited by Guanghua Wan
(hardback) 9780230538047
January 2008
Studies in Development Economics and Policy, Palgrave Macmillan

Using the latest analytical frameworks, this book conveys a comprehensive and up to date view of inequality and poverty in China.

The International Mobility of Talent: Types, Causes, and Development Impact
Edited by Andrés Solimano
(hardback) 9780199532605, February 2008
UNU-WIDER Studies in Development Economics
Oxford University Press

[This volume] brings together the best research in this critically important subject, identifying the roles of creativity, knowledge, ideas, and skills that go beyond trade and capital as the movers of economic development.
—Richard Florida, Joseph L. Rotman School of Management, author of *The Rise of the Creative Class*

Globalization and the Poor in Asia: Can Shared Growth be Sustained?
Edited by Machiko Nissanke and Erik Thorbecke
(hardback) 9780230201880, March 2008
Studies in Development Economics and Policy, Palgrave Macmillan

Domestic Resource Mobilization and Financial Development
Edited by George Mavrotas
(hardback) 9780230201767, March 2008
Studies in Development Economics and Policy, Palgrave Macmillan

Inequality and Growth in Modern China
Edited by Guanghua Wan
(hardback) 9780199535194, March 2008
UNU-WIDER Studies in Development Economics
Oxford University Press

Financial Development, Institutions, Growth and Poverty Reduction
Edited by Basudeb Guha-Khasnobis and George Mavrotas
(hardback) 9780230201774, April 2008
Studies in Development Economics and Policy, Palgrave Macmillan

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- UNU Food and Nutrition Programme for Human and Social Development (UNU–FNP)
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